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ABSTRACT

This report provides an evaluation of the implementation of the Federal Direct Student Loan Program (FDSLP) and the Federal Family Education Loan Program (FFELP), administered by the U.S. Department of Education (ED) to provide educational loans to postsecondary students and their families. The report recommends that ED: (1) ensure that FDSLP disbursement rules coincide with Pell Grant and campus-based programs; (2) ensure identical terms and conditions between FDSLP and FFELP; (3) create a comprehensive FDSLP system design to prevent disbursements from multiple sources and loans in excess of limits; (4) reassess the dependence of FDSLP on the national Student Loan Data System; (5) modify computer software and administrative procedures to minimize complexity and workload for institutions; (6) improve the timing and techniques used for institutional training; (7) improve communication between ED and institutions; (8) develop a system to monitor lender withdrawals from FFELP and changes to FFELP lender policies that can affect access to loan capital; and (9) ensure that a lender-of-last-resort is available to all students. An appendix lists the report's recommendations. (MDM)

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Implementation of the Federal Direct Student Loan Program and Modifications to the Federal Family Education Loan Program

A Report of the
Advisory Committee on
Student Financial Assistance

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IMPLEMENTATION OF THE FEDERAL DIRECT STUDENT LOAN PROGRAM AND MODIFICATIONS TO THE FEDERAL FAMILY EDUCATION LOAN PROGRAM

A Report to the Congress of the United States
and the Secretary of Education

Advisory Committee on Student Financial Assistance

August 1994

Advisory Committee on Student Financial Assistance

Room 4600, ROB-3
7th & "D" Streets, S.W.
Washington, D.C. 20202-7582
Telephone: 202/708-7439

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FOREWORD

Congress created the Advisory Committee on Student Financial Assistance when it enacted the Higher Education Amendments of 1986. The Advisory Committee serves as an independent source of advice and counsel to the Congress and the Secretary of Education on student aid policy. Congress originally defined its purpose in statute: to provide extensive knowledge and understanding of Federal, state, and institutional programs of postsecondary student assistance; to provide technical expertise with regard to systems of need analysis and application forms; and to make recommendations that will result in the maintenance of access to postsecondary education for low- and middle-income students.

The Advisory Committee's most recent focus comes from the changes made to the Higher Education Act of 1965 as amended by the Higher Education Amendments of 1992 and the Omnibus Budget Reconciliation Act of 1993. Congress has asked the Advisory Committee to conduct an evaluation of the Federal Direct Student Loan Program and the Federal Family Education Loan Program.

The Advisory Committee's structure reflects the diversity of the contemporary financial aid community. College presidents, financial aid administrators, educational association executives, bank officers, guaranty agency executives, state higher education officials, and students have served on the Advisory Committee. Members are appointed by the leaders of the United States Senate, the House of Representatives, and the Secretary of Education on the basis of technical expertise and knowledge of student aid and educational policy. The eleven members serve in staggered terms of three years. Advisory Committee members and staff are listed in Appendix B.

EXECUTIVE SUMMARY

Congress passed legislation during the last two years that has fundamentally altered the student loan programs. Congress included provisions in the Higher Education Amendments of 1992 to simplify and streamline the loan programs, expand repayment options, and increase loan limits, among many others. More recently, the Omnibus Budget Reconciliation Act (OBRA) of 1993 further modified the programs. OBRA created a phased-in Federal Direct Student Loan Program (FDSLP), in which loan volume will increase from five percent in academic year (AY) 1994-95 to at least sixty percent in AY 1998-99. OBRA also dramatically altered the financing of the Federal Family Education Loan Program (FFELP); the bill phased in a series of changes that reduced loan interest rates and subsidy levels to guarantors, lenders, and secondary markets and implemented risk-sharing with lenders and cost-sharing with states.

House and Senate OBRA conferees directed the Advisory Committee on Student Financial Assistance to advise the Secretary and the Congress on the operation of both the FDSLP and the FFELP. The Advisory Committee's primary charge is to monitor all aspects of the implementation of the FDSLP and significant modification of the FFELP. The Advisory Committee's approach flows from its previous, congressionally mandated loan simplification study that produced recommendations to reduce complexity in the FFELP and avoid complexity in the FDSLP. Using the loan simplification study as a framework, the Advisory Committee examined issue areas in both programs that corresponded to the timing of program changes and milestones for AY 1993-94. As a result, this report addresses partial implementation of the FDSLP and the preliminary or announcement effects of changes to the FFELP.

The Department of Education successfully implemented numerous essential components of the FDSLP in a timely manner and put into place significant modifications to the FFELP. In spite of these achievements, important improvements are necessary in both programs.

The Advisory Committee evaluated implementation of the FDSLP by examining the Department's progress in three broad issue areas. The areas consisted of ***program design and implementation activities, systems design and implementation, and administrative structure and processes.***

The Department had less than one year to undertake fundamental *program design and implementation activities* to bring the FDSLP on-line for 1994-95 and plan for substantial growth in the FDSLP volume and institutional participation in subsequent years. The Department successfully initiated timely procurement of contracts, development of procedures for originating direct loans, publication of regulations, and forms preparation. However, the Advisory Committee believes that basic modifications to disbursement rules and certain terms and conditions are necessary to avoid causing complexity and administrative workload in the

FDSLP. The Advisory Committee recommends that the Department take necessary legislative or regulatory steps to improve program design. The Department should:

- *Ensure that FDSLP disbursement rules coincide with the Pell Grant and Campus-Based programs; and*

- *Make terms and conditions between the FFELP and the FDSLP identical by establishing long-term solutions to certain deferment problems, such as those affecting borrowers participating in medical residencies.*

The Department's *systems design and implementation activities* allowed the FDSLP to start up by July 1, 1994. The Department fulfilled the responsibility by developing software and mainframe specifications, establishing processes vital to the operation of the FDSLP, and designing the necessary interfaces between FDSLP data bases and existing data bases. However, improvements are required in the system design, the FDSLP processing system, dependence on the National Student Loan Data System (NSLDS), and software and administrative procedures to avoid a long-term negative effect on the FDSLP. The Advisory Committee believes that the Department, which no longer faces the original time constraints, must make necessary improvements to the FDSLP. The Department should:

- *Create a comprehensive FDSLP system design based on the latest technology that addresses current shortcomings in FDSLP operations;*

- *Make key changes to the current FDSLP processing system that assure program integrity to prevent disbursements from multiple institutions and loans in excess of statutory limits;*

- *Reassess the FDSLP's dependence on the National Student Loan Data System and clarify a contingency plan in the event that the system cannot perform the functions originally anticipated in a timely fashion; and*

- *Modify the PC software and administrative procedures to minimize complexity and workload for institutions;*

The Department established critical *administrative structures and processes* to implement and maintain the FDSLP. It handled management and staffing needs, conducted the timely recruitment and selection of appropriate institutions for the AY 1994-95 FDSLP cohort, began the recruitment and selection process for the AY 1995-96 cohort, and addressed other administrative functions. The Department put important administrative structures and processes in place in a very short time. However, the Advisory Committee recommends that the Department should modify training and communications to facilitate institutional participation. In order to do so, the Department should:

- *Improve the timing and the techniques used for institutional training; and*

- *Improve communication between the Department and institutions currently participating in the FDSLP as well as institutions considering participation.*

The Higher Education Amendments of 1992 and OBRA incorporated provisions to streamline and simplify the FFELP in concert with phasing in the FDSLP. Despite concerns about FFELP stability during the implementation of the FDSLP, the program has remained healthy, in part because of a significant growth in loan volume in fiscal year (FY) 1994. In addition, other major changes to the program, such as decreased subsidy levels and expected volume losses to the FDSLP, will not occur until July 1994 and July 1995, respectively.

The Department addressed the transformation of the FFELP implementing initiatives during AY 1993-94 to avoid a possible collapse of the guaranty agency system. The initiatives included oversight of the orderly mergers of certain guaranty agencies, formation of a Transition Task Force and efforts by the Guarantor and Lender Oversight staff to ensure the stability of the guaranty agency system and creation of a Transition Guaranty Agency to deal with guaranty agency closures.

The Advisory Committee's examination of the FFELP during AY 1993-94 was limited by the staggered implementation of program changes and by lack of access to Department data about the guaranty agency system and lenders of last resort. Despite these constraints, the Advisory Committee finds that the FFELP is stable, but believes that the Department must make improvements in the areas of *monitoring lender withdrawals and changes in lender policies*, *ensuring lenders-of-last-resort*, and reassessing the viability of the *National Student Loan Data System*. The Advisory Committee proposes the following recommendations for improving the Department's oversight of the FFELP. The Department should:

- *Develop a system to monitor lender withdrawals from the FFELP and changes in FFELP lender policies that can affect access to loan capital;*

- *Ensure that a lender-of-last-resort is available to all students; and*

- *Reevaluate the planned FFELP dependence on the National Student Loan Data System to perform loan and delivery system functions, and develop a contingency that employs existing options.*

The Advisory Committee believes that implementation of these recommendations will ensure the development of an effective FDSLP and a smooth transition in the FFELP. In addition, the Department should take administrative steps to implement the Advisory Committee's recommendations to simply further the FFELP for students. Streamlining application documents and processes, minimizing the number of guarantors and lenders, and standardizing guarantor and lender policies should be considered instruments of program simplification.

INTRODUCTION

Congress has passed legislation during the last two years that has fundamentally altered the student loan programs. First, Congress included provisions in the Higher Education Amendments of 1992 to simplify and streamline the loan programs; the statute also authorized the Direct Loan Demonstration Program. In addition, it made several significant changes to the Federal Family Education Loan Program that included: expanded repayment options; increased loan limits; fewer deferment categories; an unsubsidized loan program; and requirements to standardize forms, processes, and procedures. More recently, the Omnibus Budget Reconciliation Act of 1993 further modified the programs. OBRA created a phased-in Federal Direct Student Loan Program, in which loan volume will increase from five percent in academic year 1994-95 to at least sixty percent in AY 1998-99. OBRA also restructured the FFELP by integrating Federal Supplemental Loans to Students (SLS) and the Federal Stafford Unsubsidized Loan Program and amending the lender-of-last-resort provisions. Perhaps most importantly, OBRA dramatically altered the financing of the FFELP. The bill phased in a series of changes that reduced loan interest rates and subsidy levels to guarantors, lenders, and secondary markets, and implemented risk-sharing with lenders and cost-sharing with states.

In addition, House and Senate OBRA conferees directed the Advisory Committee on Student Financial Assistance to advise the Secretary and the Congress on the operation of both the FDSLP and the FFELP. The Advisory Committee's primary charge is to monitor all aspects of the implementation of the FDSLP and modification of the FFELP. The Advisory Committee is required to report its observations annually over three years beginning in 1994 and make recommendations on the advisability of fully implementing the FDSLP in a final report due no later than January 1, 1997.

The Advisory Committee's evaluation is linked to its previous, congressionally mandated loan simplification study that produced recommendations to reduce complexity in the FFELP and avoid complexity in the FDSLP. The results of the loan simplification study appear in the 1993 publication, *Report on Student Loan Program Simplification*. Congress incorporated a number of the recommendations into OBRA. Furthermore, the study established a framework for the Advisory Committee to assess the FDSLP and the FFELP based on principles that promote: streamlined application processes, decreased institutional and student burden, reduced number of loan programs, reduced number of parties with which students must

interact, standardized processes for obtaining and repaying loans, and integration of student loans into the Title IV delivery and tracking system.

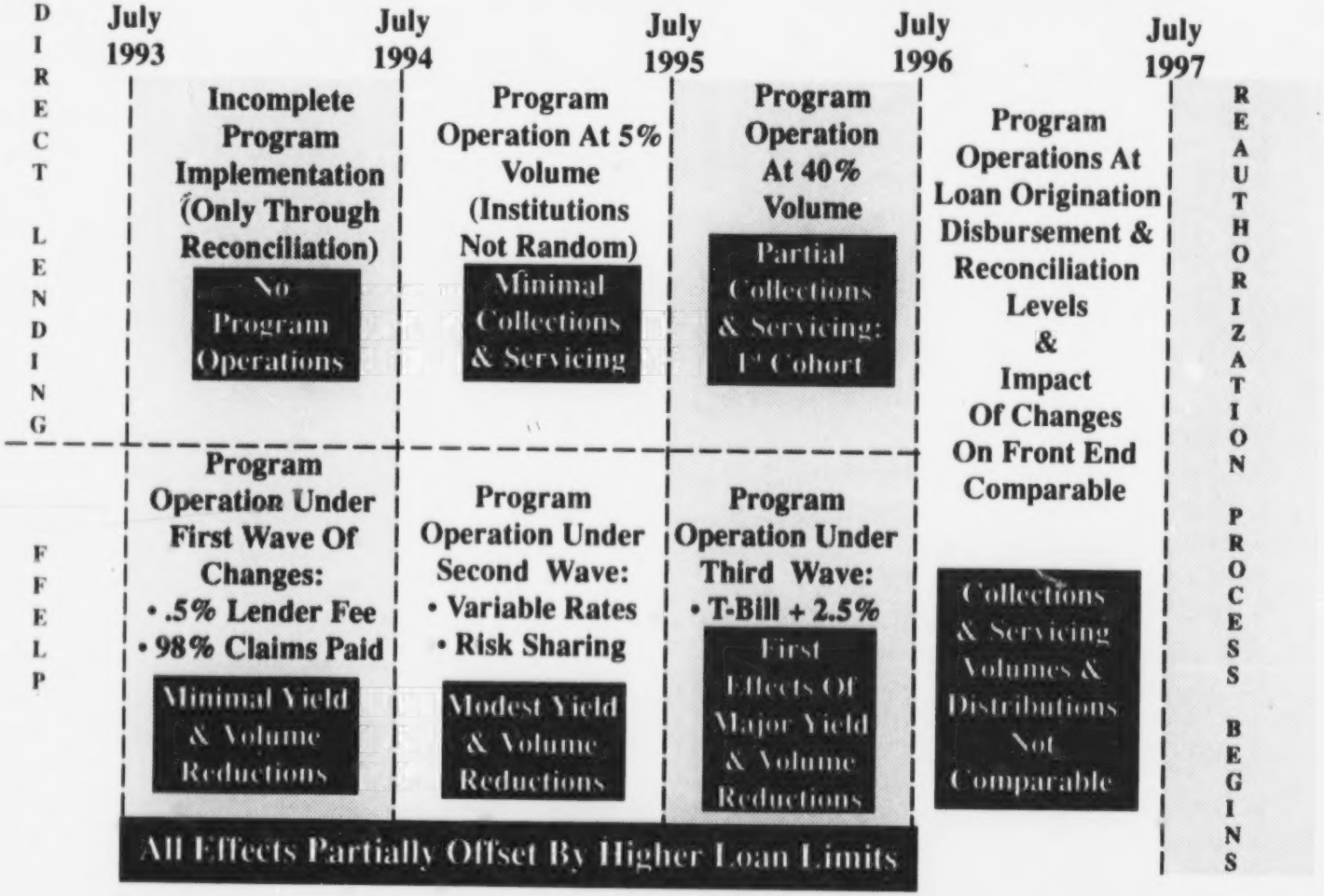
SCOPE OF THE REPORT

This report reflects the Advisory Committee's observations for the 11 months since the passage of OBRA. During this period, the Department of Education put into place essential administrative components of the FDSLP and implemented changes to the FFELP. However, the full effects of OBRA will not be observed for some time for a number of reasons. First, as Exhibit 1 shows, the FDSLP is phased-in over a period of several years. Second, as Exhibit 1 also illustrates, the modifications to the FFELP occur in stages; some of the most important changes, which will have significant impact on the programs, do not occur until July 1, 1994 and July 1, 1995. The timing of these program changes and milestones delays effects and prevents direct comparisons about relative effectiveness and costs in the near term between the FDSLP and the FFELP. Third, increased loan limits enacted under the Higher Education Amendments of 1992 are an important mitigating factor. The new loan limits produced a significant increase in FFELP loan volume in FY 1994, which has resulted in some delay in the impacts of OBRA on the FFELP participants, particularly guaranty agencies, perhaps until AY 1995-96.

This combination of factors limits the scope of the first-year evaluation and this report. Nonetheless, the Advisory Committee was able to examine important processes related to preliminary implementation of direct lending and the anticipatory or announcement effects of the changes to the FFELP that will occur in AY 1994-95.

Exhibit 1

Timing Of Legislative & Program Changes: Constraints On Loan Program Evaluations & Comparisons


DIRECT LENDING
FFELP
July 1993
July 1994
July 1995
July 1996
July 1997
Incomplete Program Implementation (Only Through Reconciliation)
No Program Operations
Program Operation At 5% Volume (Institutions Not Random)
Minimal Collections & Servicing
Program Operation At 40% Volume
Partial Collections & Servicing: 1st Cohort
Program Operations At Loan Origination Disbursement & Reconciliation Levels & Impact Of Changes On Front End Comparable
Collections & Servicing Volumes & Distributions Not Comparable
Program Operation Under First Wave Of Changes:
• .5% Lender Fee
• 98% Claims Paid
Minimal Yield & Volume Reductions
Program Operation Under Second Wave:
• Variable Rates
• Risk Sharing
Modest Yield & Volume Reductions
Program Operation Under Third Wave:
• T-Bill + 2.5%
First Effects Of Major Yield & Volume Reductions
All Effects Partially Offset By Higher Loan Limits
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FEDERAL DIRECT STUDENT LOAN PROGRAM

Congress transformed the relatively small Direct Loan Demonstration Program into a major program with the enactment of OBRA on August 10, 1993. It presented the Department with the challenge of an 11-month implementation schedule in order to begin making loans on July 1, 1994 at 104 institutions that account for approximately five percent of the FFELP's FY 1991 loan volume. The Department also faced the task of establishing the FDSLP to accommodate sharp increases in loan volume beginning at five percent and rising to at least 60 percent over a four-year period from AY 1994-95 to AY 1998-99.

The Advisory Committee evaluated implementation of the FDSLP by examining the Department's progress in three broad issue areas. The areas consisted of ***program design and implementation activities, systems design and implementation, and administrative structure and processes***. The following narrative describes the Advisory Committee's observations and recommendations.

PROGRAM DESIGN AND IMPLEMENTATION ACTIVITIES

The Department had less than one year to create a program design and initiate basic implementation activities that could bring the FDSLP on-line for AY 1994-95 and that could accommodate substantial growth in the FDSLP volume and institutional participation in subsequent years. The Department successfully initiated essential program design and implementation activities critical to the success of the FDSLP, including:

- Completion of a master calendar;
- Procurement on schedule of important contracts, such as software development, loan servicing, payment management and funds delivery, training, and evaluation;
- Development of procedures for originating, servicing, and collecting direct loans;
- Publication of all regulations governing the program for AY 1994-95 and certain regulations for 1995-96;
- Participation in negotiated rulemaking to develop regulations for AY 1995-96 and beyond;
- Establishment of the Free Application for Federal Student Aid (FAFSA) as the FDSLP application; and
- Production of promissory notes, deferment forms, and applications for loan consolidation on time for the July 1, 1994 implementation date.

These activities are critical to starting the FDSLP on schedule and maintaining it once it becomes operational. The Department's success demonstrates its capacity to implement essential components of the FDSLP.

However, the Advisory Committee believes that basic modifications to *disbursement rules* and certain *terms and conditions* are necessary to avoid complexity and increased administrative workload in the FDSLP which may require statutory changes. These issues should be addressed before AY 1995-96 when loan volume could rise to 40 percent and the number of participating schools could reach between 1,000 and 2,000.

The Department has interpreted OBRA to require that FDSLP use certain FFELP disbursement rules that are likely to produce administrative complexity for institutions. First, the regulations require multiple disbursements for periods as short as a single term or semester. Second, under the current FDSLP rules, institutions do not have the flexibility, as they do for Perkins loans, to offer unequal disbursements of FDSLP to accommodate differences in costs between payment periods within an academic year, except limited circumstances. Third, the regulations require institutions to reconfirm enrollment status on the date of disbursement, instead of accepting the enrollment used for the Pell Grant and Campus-Based programs.

OBRA contains inconsistencies that result in utilization of the FFELP disbursement requirements in the FDSLP. For example, the statute mandates FDSLP payment periods that mirror the Pell Grant program but also references a section in part B of the statute that prescribes FFELP disbursements. The first-year regulations reflect the requirements of the FFELP, which will prove burdensome for FDSLP institutions without improving program integrity.

The Department also has interpreted OBRA to require the use of terms and conditions of the FDSLP program that are not consistently parallel with the FFELP for borrowers engaged in medical residencies. The statute specifies that the FDSLP's terms and conditions are to correspond to those in the FFELP. However, the Department has determined that the statute does not permit borrowers who are eligible for medical residency deferments on their outstanding FFELP loans to defer their FDSLP loans, because the statute does not specifically grandfather residency deferments under the FDSLP as it does for the FFELP. Some medical schools either have withdrawn from the 1994-95 cohort of direct lending institutions or have submitted conditional

applications for the AY 1995-96 in response. The Department has addressed the issue for AY 1995-96 through a consolidation option. Although, at least one medical school has reconsidered its participation, the medical school community views the approach as an incomplete, short-term remedy.

The Advisory Committee recommends that the Department take necessary legislative or regulatory steps in the area of program design and implementation activities to:

- *Ensure that FDSLP disbursement rules coincide with the Pell Grant and Campus-Based programs.*
- *Make terms and conditions between the FFELP and the FDSLP identical by establishing long-term solutions to certain deferment problems, such as those affecting borrowers participating in medical residencies.*

SYSTEMS DESIGN AND IMPLEMENTATION

The Department designed and implemented systems that allowed the FDSLP to start up by July 1, 1994. The Department fulfilled the responsibility by:

- Developing and delivering on time software and mainframe specifications based on its EDExpress software package;
- Establishing processes vital to the operation of FDSLP, such as institutional draw-downs and distribution of funds through the Department's Payment Management System (EDPMS) and alternate disbursement; and
- Designing interfaces for the FDSLP data bases with existing data bases, such as the Central Processing System (CPS) and using the General Electronic Support (GES) system to transmit information.

The Department produced workable software, processes, and systems within a compressed time-frame. It also responded to a range of concerns about shortcomings in the software that were identified by the Advisory Committee and institutions.

Nonetheless, improvements are required in the *system design*, *FDSLP processing system*, *dependence on the National Student Loan Data System*, and *software and administrative procedures* to avoid long-term negative effects on the FDSLP. The Advisory Committee believes that the Department, which no longer faces the original time constraints for

starting up the FDSLP, must initiate systems and software changes to design improvements.

The software and systems lack a comprehensive system design. The Department has developed software and systems based on the original Federal Direct Loan Demonstration Program without an ongoing design assessment to accommodate the change to a large-scale FDSLP. The absence of a comprehensive design has produced two sets of problems. First, the current system relies on relatively outdated and unnecessarily time-consuming technology, such as batch processing rather than on-line communication. Second, operational shortcomings have emerged, which are represented by other issues in systems design and implementation described in this section.

The FDSLP processing system, similar to other Title IV systems, permits disbursements to a borrower from more than one institution and allows certain students to receive loans in excess of statutory loan limits. Disbursements to a borrower from multiple institutions occur because of delays in the loan servicing system, caused by the Department's procedural and technological approaches. Specifically, burdensome procedures for updating information after transmitting borrower records to the loan servicing system have created a disincentive for institutions to book loans (i.e., transmit origination, promissory note and disbursement data to the servicer) promptly. As a result, many institutions will delay transmission of loan data to the servicer until after disbursement, potentially permitting students to receive loans at multiple institutions. The system also uses batch processing rather than real-time, on-line processing, which delays communication with institutions.

Certain borrowers can receive loans in excess of loan limits because the software and loan servicing system do not capture critical data elements or conduct important edits. For example, the institutional FDSLP software and the loan servicing system do not have data fields for cumulative debt, and thus cannot flag borrowers who have reached aggregate maximum loan levels. The National Student Loan Data System was to track loan limits, but NSLDS is not yet operational. In addition, the Department did not design the loan servicing system to capture dependency status, a criterion for determining borrower annual loan limits. The Department has linked the loan servicing system to the Central Processing System, which contains dependency status data; however, the loan servicing system apparently does not contain an edit for dependency status to ensure that dependent students, eligible for

lower amounts than independent students, do not receive loans in excess of statutory limits.

The Department cannot depend in the near-term on the National Student Loan Data System to track aggregate loan limits or other functions for the FDSLP. The Department had planned to use NSLDS under the assumption it would be fully operational by start-up of the FDSLP. However, NSLDS, originally scheduled to be operational by July 1, 1993, has been subject to a series of delays that prevented the system from coming on-line by July 1, 1994, the FDSLP implementation date. Although a fall 1994 start up now is anticipated, the massive task of populating the data base with the guaranty agency records needed to track aggregate loan limits is scheduled to take place throughout the fall and winter of 1994. Additional delays are possible because the Department is reexamining the role and functions of NSLDS and how it fits with other Title IV systems. Furthermore, the link between institutions and NSLDS to permit submission of Student Status Confirmation Reports will be phased in at institutions over a period of years. As a result, the Department has initiated an alternate mechanism for collecting enrollment data through the FDSLP servicer.

The PC software and associated administrative procedures designed by the Department produce complexity and increased workload for institutions using the FDSLP PC software. Institutions using mainframe computers have not experienced these problems. For example, the FDSLP PC software is loan-specific rather than borrower-specific. It requires institutions to key and rekey a significant amount of information on all borrower records and to create separate loan records to certify subsidized and unsubsidized loans. In addition, institutions must engage in a time-consuming manual process to transmit and receive data that involves downloading and uploading information to and from EDExpress and expEDIte, the Department's communications software package. Further, the Department has provided software designed primarily for IBM-compatible hardware; institutions with MacIntosh computer hardware are required to correct the software resulting in extra processing time and steps for these institutions. However, the Department has announced plans to implement the necessary improvements.

The Advisory Committee nas developed four systems design and implementation recommendations. The Department should:

- *Create a comprehensive system design based on the latest technology that addresses current shortcomings in FDSLP operations.*
- *Make key changes to the current FDSLP processing system that assure program integrity to prevent disbursements from multiple institutions and overawards.*
- *Reassess the FDSLP's dependence on the National Student Loan Data System and clarify a contingency plan in the event that the system cannot perform the functions originally anticipated in a timely fashion.*
- *Modify the PC software and administrative procedures to minimize complexity and workload for institutions.*

ADMINISTRATIVE STRUCTURES AND PROCESSES

The Department successfully established critical administrative structures and processes to implement and maintain the FDSLP. Its activities in this area included:

- Handling management and staffing needs;
- Conducting the timely recruitment and selection of appropriate institutions for the AY 1994-95 FDSLP cohort;
- Beginning the recruitment and selection process for the AY 1995-96 institutional cohort;
- Promptly issuing task orders for training in AY 1994-95 and AY 1995-96; and
- Providing certain communications and customer services.

The Department addressed management and staffing needs by assembling a management team, known as the Direct Loan Task Force, to lead implementation of the FDSLP. It also arranged to hire consultants and permanent staff to assist with internal program operations.

The Department selected the first cohort of institutions by November 15, 1993, choosing 104 institutions from over 1,100 institutional applicants. The first cohort meets OBRA's target of five percent of FY 1991 FFELP volume (approximately $730 million). Large public institutions provided the anticipated majority of the AY 1994-95 volume. Eighteen public institutions represent an estimated 67 percent of the volume.

The Department also moved quickly to select the second cohort which will begin lending in AY 1995-96 by designating eligible institutions that applied, but were not selected, for the first cohort and by accepting additional applications on a rolling basis. To date, 1,174 institutions have been named for the second cohort, representing a reported total loan volume of more than 30 percent of FY 1991 FFELP's volume. The AY 1995-96 target is 40 percent.

The Department was prompt in issuing task orders to produce a training program for the first cohort on program specifications and software operation. The tight implementation schedule for the FDSLP affected the development of the workshops, which began in January 1994. Training had to be divided into two modules requiring institutions to attend two sets of workshops since cash management procedures and software were not ready until April 1994.

The Department recognized the importance of communications with institutions by initiating a customer service and technical support system that included making the Direct Loan Task Force highly visible and accessible. As a service to institutions, the Department also developed loan counseling brochures and videos.

The Department effectively put important administrative structures and processes in place in a very short period. However, the Advisory Committee finds that improvements are needed in *training* and *communications* to facilitate institutional participation.

The Department conducted FDSLP training late in the AY 1994-95 award cycle and employed limited training techniques. The Department scheduled training workshops for AY 1994-95 to extend from January to April 1994, thus providing important information too late for institutions that began packaging early in the calendar year. The Department has responded to feedback from institutions and will begin initial training of the new institutions in July 1994. However, the Department plans to maintain the original January through April schedule for up-date training.

The Department relied on printed materials distributed to trainees at the workshops from which instructors very often read aloud. Although the workshops provided hands-on training for the software, these sessions were often too rushed for trainees to acquire the experience they needed. The challenge of providing meaningful training for AY 1995-96 is considerably greater because the Department will be bringing as many as 2,000 institutions into the FDSLP.

The Department's ability to communicate effectively about the FDSLP has not been consistent, creating difficulties for both FDSLP institutions and institutions considering participation. The Department had established an electronic bulletin board to network FDSLP institutions with the Department. The project suffered from contract problems, became inoperable soon after being brought on-line, and could not

provide the communication services expected in advance of AY 1994-95 implementation. The Department apparently did not have an adequate backup plan for disseminating information when the electronic bulletin board did not function. However, the Department subsequently produced a series of periodic bulletins for institutions and recently made the electronic bulletin board operational.

Institutions considering participation in the FDSLP also had trouble obtaining information. The Department did not provide regular mailings about the program and did not share technical materials. Institutions could request training manuals from the Department's Public Inquiry Contractor (PIC); however, the Department did not inform schools of this availability. Although the Department is working on the problems, continued inability to provide information about the FDSLP quickly and easily could reduce institutional interest in the program.

The Advisory Committee proposes two recommendations for administrative structure and processes:

- *Improve the timing and the techniques used for institutional training.*
- *Improve communication between the Department and institutions currently participating in the FDSLP as well as institutions considering participation.*

A compilation of the Advisory Committee's recommendations for the FDSLP appears in Appendix A.

FEDERAL FAMILY EDUCATION LOAN PROGRAM

The Higher Education Amendments of 1992 and the Omnibus Budget Reconciliation Act of 1993 incorporated provisions to streamline and simplify the Federal Family Education Loan Program and to achieve significant cost savings. The streamlining and simplification provisions consisted of requiring a common FFELP application and revising the FFELP's financing structure over time to encourage a reduction in the number of lenders and a consolidation of guaranty agencies.

Despite concerns about the stability of the FFELP through the FDSLP implementation, the program has remained healthy. In FY 1994, the FFELP experienced a significant growth in loan volume as a result of expanded loan limits enacted by the Higher Education Amendments of 1992, as Exhibit 2 indicates. The substantial increase in loan volume has had the effect of reducing the impacts of OBRA's modifications to the FFELP's financing structure that, for 1993-94, included: multiple disbursements of PLUS loans; lender payment of a .5 percent lender origination fee; payment of a monthly fee to the Department by Federal Consolidation Loan holders, based on the volume of their portfolios of these loans; and claim payments to lenders of 98 percent.

The effects anticipated from the statutory provisions also have been minimal not only as a result of increased loan volume, but also because other major changes to the program, such as decreased subsidies and expected additional volume losses to the FDSLP, will not occur until July 1994 and July 1995.

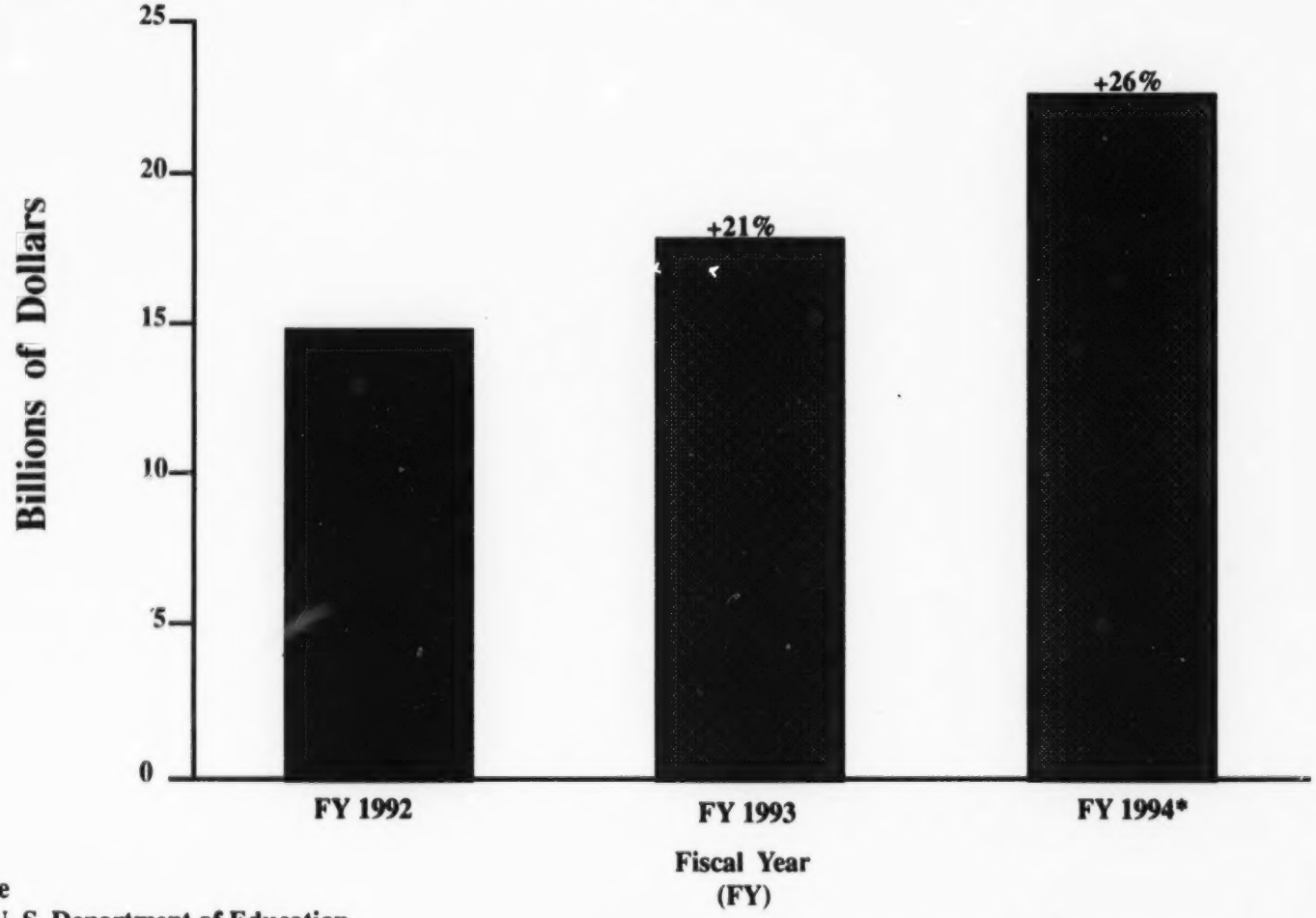
The Department addressed the t[illegible]formation of the FFELP by implementing the following initiatives during AY 1993-94 to avoid a possible collapse of the guaranty agency system:

- Oversight of the orderly mergers process of certain guaranty agencies;
- Formation of a Transition Task Force and efforts by the Guarantor and Lender Oversight staff to ensure the stability of the guaranty agency system; and
- Creation of a Transition Guaranty Agency to deal with guaranty agency closures.

The Department oversaw the merger of the Puerto Rico Higher Education Assistance Corporation with the Great Lakes Education Loan

Exhibit 2

Impact of the Higher Education Amendments of 1992: Increase in FFELP Loan Volume FY 1992-FY 1994



*Estimate
Source: U. S. Department of Education

Corporation, with other mergers likely to take place in the coming years. The Student Loan Fund of Idaho ceased operation on June 30, 1994, and has merged with Northwest Education Loan Association. The Maryland Higher Education Loan Program, which state legislation abolished effective July 1996, is currently seeking an agency with which to merge. The Mississippi Guaranteed Student Loan Agency also will merge with an undetermined agency.

To facilitate orderly mergers, the Transition Task Force began visits to five of the most financially stable guaranty agencies to assess their capacity and willingness to assume other agencies' portfolios. The Transition Task Force also planned visits to agencies that probably cannot survive another five years to obtain from each a realistic assessment of their solvency and to provide them with an opportunity to consolidate with stronger agencies. In addition, the Guarantor and Lender Oversight staff obtained reports on individual institutional loan volumes held by each guarantor, giving the Department data to predict any agency's loss of volume when an institution chooses to participate in the FDSLP.

Other oversight activities involved closer scrutiny of guaranty agency activities during AY 1993-94. The Guarantor and Lender Oversight staff served notice to the Education Assistance Corporation of South Dakota of the Department's intent to terminate its agreement based on significant administrative irregularities, an action that the agency is appealing. It also required one guaranty agency to restore four million dollars to its guaranty agency reserves that were inappropriately spent on state scholarships. In addition, the Department used the negotiated rulemaking process to determine a common formula for establishing guaranty agency reserve levels for all future measures of guarantor solvency with minimum levels to be enforced beginning in 1995.

The Department also undertook the unprecedented action of establishing the Transition Guaranty Agency (TGA). TGA is designed to manage an insolvent agency until another guaranty agency is able to assume the portfolio. The existence of TGA increases the options available to the Department and strengthens its position in discussions with guarantors.

The Advisory Committee's examination of the FFELP during AY 1993-94 was limited by the phased implementation of program changes and by lack of access to Departmental data concerning the financial health of guaranty agency system and lender-of-last-resort agreements. Despite these constraints, the Advisory Committee finds that the

FFELP shows signs of stability, but believes that the Department must address shortcomings in its approach to avoid future problems. These shortcomings are in the areas of *monitoring lender withdrawals and changes in lender policies*, *ensuring lenders-of-last-resort*, and reassessing the viability of the *National Student Loan Data System*.

The Department has not established a system to monitor significant changes in lender FFELP policies and lender withdrawals from the program. Access to loan capital does not appear to be in jeopardy as evidenced by the increase in FFELP volume in FY 1994. While smaller banks may be leaving the program, only one major lender--NationsBank--has announced a decision to withdraw. However, the Department believes that FFELP capital will remain in ample supply. Consequently, it has not established a systematic mechanism to monitor lender participation or loan access. This could leave the Department unprepared for market shifts in lender participation and delay delivery of loan funds to students as institutions search for alternate lenders.

Lender-of-last-resort programs do not appear to be available to all students. Congress clearly intended that lenders-of-last-resort be available to all students either through the Student Loan Marketing Association (Sallie Mae) or the guaranty agencies. The Department entered into a $200 million agreement with Sallie Mae during the second quarter of FY 1994 to assure unimpeded access to lender-of-last-resort loans. Amid sporadic reports from the financial aid community of access problems, especially for proprietary schools, the Department has not shared details of its lender-of-last-resort plans or the states that have approved programs. However, anecdotal information suggests that a number of states do not have operational programs because guaranty agencies are concerned about the Department's policy to count defaults from these loans against reinsurance trigger rates, even though the loans themselves are reinsured at 100 percent.

The National Student Loan Data System has yet to become operational. Congress authorized NSLDS in 1986 to serve as a centralized source of information about borrowers' indebtedness and as a management tool to oversee the FFELP. The reasons for delay in implementation are twofold. First, the Department has grafted additional functions to the project so that the vast amount of data now needed to operate the system potentially threatens its viability. Second, some required data are not readily available from the guaranty agencies, which will have to rely on lenders for data at a time when the transition to the FDSLP and

changes to the FFELP are likely to result in guarantors and lenders leaving the program. Also, the quality of the data is questionable given historical problems with tape dump data provided by guaranty agencies to the Department.

Once NSLDS does become operational, the transmission of the amount of data necessary to maintain the system is likely to reduce its capacity for lenders and institutions to query for information. This may mean that the system will not be able to perform certain functions, possibly for years, such as processing Student Status Confirmation Reports and financial aid transcripts. In this regard, the Department's development of NSLDS was not conducted in the context of broader delivery system issues; nor has the Department created a contingency plan for the interim, which could include employing existing options.

The Advisory Committee proposes the following recommendations for improving the Department's oversight of the FFELP. The Department should:

- *Develop a system to monitor lender withdrawals from the FFELP and changes in FFELP lender policies that can affect access to loan capital.*
- *Ensure that a lender-of-last-resort is available to all students.*
- *Reevaluate fully the planned FFELP dependence on the National Student Loan Data System to perform loan and delivery system functions, and develop a contingency that employs existing options.*

In addition, the Department should take administrative steps to implement the Advisory Committee's recommendations to simplify further the FFELP for students. The Advisory Committee's recommendations resulting from the Loan Simplification Study provided concrete steps that could be taken to simplify the program. Streamlining application documents and processes, minimizing the number of guarantors and lenders, and standardizing guarantor and lender policies should be considered as instruments of program simplification.

Appendix A contains recommendations for the FFELP in combination with its recommendations for the FDSLP.

APPENDIX A

RECOMMENDATIONS FOR THE FEDERAL STUDENT LOAN PROGRAMS

FDSLP

Program Design and Implementation Activities

- *Ensure that FDSLP disbursement rules coincide with the Pell Grant and Campus-Based programs.*
- *Ensure identical terms and conditions between the FFELP and the FDSLP by establishing long-term solutions to certain deferment problems, such as those affecting borrowers participating in medical residencies.*

Systems Design and Implementation

- *Create a comprehensive system design based on the latest technology that addresses current shortcomings in FDSLP operations.*
- *Make key changes to the current FDSLP processing system that assure program integrity to prevent disbursements from multiple institutions and loans in excess of statutory limits.*
- *Reassess the FDSLP's dependence on the National Student Loan Data System and clarify a contingency plan in the event that the system cannot perform the functions originally anticipated in a timely fashion.*
- *Modify the PC software and administrative procedures to minimize complexity and workload for institutions.*

Administrative Structure and Processes

- *Improve the timing and the techniques used for institutional training.*
- *Improve communication between the Department and institutions currently participating in the FDSLP as well as institutions considering participation.*

FFELP

- *Develop a system to monitor lender withdrawals from the FFELP and changes in FFELP lender policies that can affect access to loan capital.*
- *Ensure that a lender-of-last-resort is available to all students.*
- *Reevaluate fully the planned FFELP dependence on the National Student Loan Data System to perform loan and delivery system functions, and develop a contingency that employs existing options.*

APPENDIX B

LIST OF MEMBERS AND STAFF
Advisory Committee on Student Financial Assistance
Current Members by Class of Appointment

Class of 1994
(Term expires September 30, 1994)

Dr. Robert E. Alexander
Chancellor
University of South Carolina-Aiken
Aiken, South Carolina 29801
(Secretary of Education appointee)

Mr. Robert A. Kraig
Madison, Wisconsin 53703
(Secretary of Education appointee)

Dr. William C. Hiss
Vice President for Administrative Services
and Dean of Admissions
Bates College
Lewiston, Maine 04240
(U.S. Senate appointee)

Dr. Joseph L. McCormick
Executive Director
Alaska Commission on Postsecondary Education
Juneau, Alaska 99801-7109
(U.S. House of Representatives appointee)

Class of 1995
(Term expires September 30, 1995)

Mr. Stephen C. Biklen
President
The Student Loan Corporation
Pittsford, New York 14534
(House of Representatives appointee)

Ms. Elizabeth M. Hicks
Coordinator of Financial Aid
Harvard University
Cambridge, Massachusetts 02138
(Secretary of Education appointee)

Dr. Stanley Z. Koplik
Chancellor
Commonwealth of Massachusetts
Higher Education Coordinating Council
Boston, Massachusetts 02108-1696
(U.S. Senate appointee)

Ms. Vernetta P. Fairley
Director of Financial Aid
University of Southern Mississippi
Hattiesburg, Mississippi 39402
(Secretary of Education appointee)

Class of 1996
(Term expires September 30, 1996)

Ms. Lynn M. Fawthrop
Director of Financial Aid
Roger Williams University
Bristol, Rhode Island 02809
(U.S. Senate appointee)

Mr. Thomas A. Butts
Associate Vice President for
Government Relations
University of Michigan
Ann Arbor, Michigan 48109
(House of Representatives appointee)

Mr. Fernando de Necochea
Director of Financial Aid
Brown University
Providence, Rhode Island 02912
(Secretary of Education appointee)

Advisory Committee Staff

Dr. Brian K. Fitzgerald
Staff Director

Dr. William J. Goggin
Staff Economist

Ms. Hope M. Gray
Staff Assistant

Ms. Tracy D. Jones
Staff Secretary

Ms. Ardena N. Leonard
Research Assistant

Ms. Debra L. Schweikert
Associate Director